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Supreme Court of the United States

OCTOBER TERM, 1942

No. 156.

THE DETROIT BANK, formerly The [illegible] Savings Bank, a Michigan Banking Corporation,
Petitioner,

v.

THE UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your Petitioner, THE DETROIT BANK, formerly The Detroit Savings Bank, a Michigan banking corporation, respectfully represents that:

This case involves a simple but vital problem of fundamental justice and fairness between sovereign and citizen.

It is difficult to believe that there can exist anywhere, except perhaps in the so-called jurisprudence of Hitler's Germany, a principle of law sanctioning, by the imposition of a secret lien, the confiscation by the government of the United States of property owned by one of its citizens. The court below applied that arbitrary precept to sanction the seizure of the property of one of its citizens in satisfaction of taxes assessed against another. Indeed, that unprecedented depredation was permitted even though the owner of the property was a complete stranger to the transaction which gave rise to the tax and acquired the expropriated property in good faith, for value, and without any knowledge or reason to know or suspect any actual or potential claim on the part of his Government. If the decision of the court below is upheld that unconscionable doctrine will become imbedded in our law—forever a bitter reproach to the institutions of a free people.

John P. Paul died intestate at Detroit, Michigan, on May 6, 1926 (R-102). At the time of his death he and his wife, Lena Paul, owned as tenants by the entirety a considerable number of parcels of real estate located in that city (R-230). By the law of the State of Michigan (following the common law), Lena Paul acquired immediately upon the creation of the estate by the entirety, the right to one-half of the income and the right to the whole of the estate in the event she survived her husband. Lena Paul, as surviving tenant, became, immediately upon her husband's death, the sole owner of the aforementioned several parcels of real estate. Two of these parcels were then encumbered by mortgages held by Petitioner securing indebtedness in excess of $35,000.00 (R-233, 234). Subsequent to her husband's death and before assessment of the tax here involved, Lena Paul mortgaged ten of the parcels, which, with one exception

(R-230, 236) she and her husband had owned as tenants by the entirety, to Petitioner to secure indebtedness aggregating approximately $178,900.00 (R-230, 235-238). Petitioner acquired all of these mortgages in good faith and without any knowledge that Respondent had or claimed to have any interest in or claim on the property covered thereby (R-239). Default occurred in all of these mortages, including those made prior to the death of John P. Paul, and Petitioner thereupon foreclosed all of these mortgages. In each instance Petitioner became the purchaser at the foreclosure sale, bidding at such sales an aggregate of $263,196.87 for all of the property under foreclosure (R-233,238). The fact that the aggregate amount bid for these properties exceeded the amount originally secured by the mortgages which encumbered them is accounted for by the fact that Petitioner's bid included accrued interest and advances made by Petitioner to pay real estate taxes and premiums on insurance (R-233-238). The foreclosure sales were all completed prior to May 4, 1936 (R-233-238).

On May 4, 1936, just two days short of the tenth anniversary of John P. Paul's death (which was the date on which the lien for Estate Taxes expired), Respondent instituted the present suit (R. v). The Bill of Complaint alleged that there were unpaid Federal Estate Taxes due from the estate of John P. Paul, that Respondent had a lien therefor which arose upon Mr. Paul's death and continued for ten years thereafter, that even though unfiled and unrecorded, this lien was valid against subsequent good faith purchasers and encumbrancers of property which comprised a part of Mr. Paul's gross estate, including that in which he had an interest as a tenant by the entirety and that Respondent was entitled to have the property which Petitioner acquired upon the foreclosure of the aforementioned mortgages applied in

satisfaction of that lien (R-1-47). The Bill of Complaint further alleged and the evidence adduced in the District Court established the following facts (of none of which Petitioner was aware at the time it acquired the aforementioned mortgages): On or about July 5, 1927, Lena Paul, describing herself as "widow of John P. Paul, and joint owner of all of his property" filed a Federal Estate Tax Return covering the estate of her husband (R-229). In this return she reported a gross estate of $492,902.00, deductions of $329,823.49, a net estate of $164,078.51, and an estate tax liability of $3,450.00, which was duly paid (R-229). Under date of March 14, 1930, the Commissioner of Internal Revenue of the United States of America notified Lena Paul, as beneficiary of her husband's estate, of a deficiency of $23,271.84 in Estate Taxes payable with respect to that estate (R-229, 230). Within the time allowed by law, a petition was filed with the United States Board of Tax Appeals for a redetermination of the asserted deficiency (R-230). On November 4, 1932, the United States Board of Tax Appeals sustained the deficiency asserted by the Commissioner of Internal Revenue and entered its order accordingly (R-230). No appeal was taken from this order and on February 19, 1933, the Commissioner of Internal Revenue assessed against the estate of John P. Paul the aforementioned deficiency in the principal amount of $23,271.84, together with interest in the amount of $8,080.28 (R-230). No part of this deficiency or the interest thereon has been paid (R-230).

As stated above, the present suit was commenced by Respondent on May 4, 1936, in the United States District Court for the Eastern District of Michigan, Southern Division, to collect the aforementioned deficiency by foreclosure of its lien for Estate Taxes against fifty

parcels of real estate, twelve of which were those which Petitioner acquired as a result of the foreclosure of the aforementioned mortgages which it held (R-229, 233, 235-238). The remaining thirty-eight parcels are owned by persons other than Petitioner. Twenty-five of these remaining parcels are unencumbered and are owned by one or more of the children of John P. Paul and Lena Paul, or by the heirs of such of said children as are now dead (R-232, 233). The balance of the remaining parcels are encumbered by mortgages held by persons (other than Petitioner) who were also defendants in the District Court, some of which mortgages have now been foreclosed (R-234, 235, 238). All of the mortgages were made by either John P. Paul and Lena Paul, by Lena Paul alone or by descendants of John P. and Lena Paul (R-233, 235). Those made by both John P. Paul and Lena Paul having been made prior to the former's death and those made by Lena Paul or by the descendants of John P. and Lena Paul having been made subsequent to John P. Paul's death. The State of Michigan and two of its political subdivisions, the County of Wayne and the City of Detroit were also parties defendant by reason of liens which each possessed for unpaid real estate taxes assessed against the property in question and the issue of priority as between such liens and that of the United States is involved.

The case being one in equity, it was tried by the District Court upon a stipulation of facts supplemented by testimony. Only such of the facts as relate to the controversy between Respondent and this Petitioner are set forth in detail above.

The District Court found that Petitioner acquired all of the mortgages (which it held covering property owned

by John P. Paul and Lena Paul, as tenants by the entirety, prior to the former's death) in good faith, for value, and without any knowledge that Respondent had or claimed to have any lien, claim or charge on any of said property (R-239).

The District Court further found that *Section* 315 (*a*) *of the Revenue Act of* 1926 (*Section* 827 (*a*) *of the Internal Revenue Code*) imposes a lien for the collection of Federal Estate Taxes, which is separate and distinct from the general tax lien created by *Section* 3186 *of the Revised Statutes* (*Sections* 3670 *to* 3677 *of the Internal Revenue Code*) and that the provisions of *Section* 3186 *of the Revised Statutes* requiring that notice be filed or recorded to make the lien imposed by the latter section valid as against bona fide purchasers and encumbrancers, had no application to the lien imposed by *Section* 315 (*a*) *of the Revenue Act of* 1926. It concluded, contrary to Petitioner's contention, that the lien imposed by *Section* 315 (*a*) *of the Revenue Act of* 1926 arises upon the death of a decedent whose estate is liable for the payment of Federal Estate Taxes and is valid against subsequent purchasers and encumbrancers for value of property subsequently held to form a part of such decedent's gross estate, even though such purchasers and encumbrancers became such in good faith and without any knowledge of the existence or claimed existence of any such lien. The District Court also rejected Petitioner's contention that as so construed *Sectoin* 315 (*a*) *of the Revenue Act of* 1926 violated the Fifth Amendment of the Constitution of the United States and Petitioner's further contention that the lien described in that section in no event attached to property held by a decedent and his spouse as tenants by the entirety. The District Court, in conformity with Petitioner's contention, held that the lien

of those mortgages held by Petitioner, which antedated the death of John P. Paul, being prior in time, were superior in right to the lien asserted by Respondent in these proceedings.

The District Court also found that the lien asserted by Respondent in this case being prior in time was superior in right to the liens asserted by the State of Michigan and its political subdivisions regardless of notice. The State of Michigan and its subdivisions have filed or will shortly file a separate petition for certiorari to review the decision of the Circuit Court of Appeals with respect to them.

Section 315 (*a*) *of the Revenue Act of* 1926 and *Section* 3186 *of the Revised Statutes* are for the convenience of this Honorable Court set forth in full in the Appendix to this Petition.

The findings of fact and conclusions of law of the District Court, which are reported in 41 *Fed. Supp.* 41 are found on pages 229 to 243, both inclusive, of the record; the Court's decree on pages 247 to 256, both inclusive.

Upon appeal by Petitioner (and several other defendants in the District Court including the State of Michigan, the County of Wayne, and the City of Detroit) to the United States Circuit Court of Appeals for the Sixth Circuit, that Court, in a brief opinion, affirmed the decision of the District Court. The opinion of the Circuit Court of Appeals (R. 290) is reported in 127 *Fed.* (2*nd*) 64.

Judgment was entered April 8, 1942.

THIS PETITION PRESENTS FOUR QUESTIONS:

I.

Does Section 315 (a) of the Revenue Act of 1926 (the Estate Tax Law) (Section 827 (a) of the Internal Revenue Code, as amended) impose a lien separate and distinct from that imposed by Section 3186 of the Revised Statutes of the United States (general Internal Revenue provisions) (Sections 3670 to 3677 of the Internal Revenue Code, as amended)?

The District Court and the Circuit Court of Appeals both determined that the lien imposed by *Section* 315 (*a*) *of the Revenue Act of* 1926 was separate and distinct from that imposed by *Section* 3186 *of the Revised Statutes of the United States.*

II.

Is it necessary that the lien herein sought to be foreclosed be filed or recorded in the manner prescribed by Section 3186 of the Revised Statutes of the United States (Sections 3670 to 3677 of the Internal Revenue Code, as amended) to make the same effective against bona fide purchasers and encumbrancers?

Both the District Court and the Circuit Court of Appeals answered this question in the negative.

III.

Does the lien herein sought to be foreclosed attach to property owned by a decedent, as one of the tenants of an estate by the entirety?

Both the District Court and the Circuit Court of Appeals answered this question in the affirmative.

IV.

If Section 315 (a) of the Revenue Act of 1926 (Section 827 (a) of the Internal Revenue Code, as amended) is construed as imposing a lien which is effective against bona fide purchasers and encumbrancers without filing or recording, does that section as so construed violate the Fifth Amendment to the Constitution of the United States?

Both the District Court and the Circuit Court of Appeals answered this question in the negative.

BASIS OF JURISDICTION.

Jurisdiction is invoked under *Section* 240 (*a*) *of the Judicial Code, as amended by the Act of February* 13, 1925, 43 *Stat.* 938; 28 *USC* 347 (*a*).

Petitioner is advised and believes that the judgment of the Circuit Court of Appeals is erroneous and contrary to the just rights of Petitioner, and that this Court should require said cause to be certified to this Court for its review and determination, in conformity with the provisions of the Act of Congress in such case made and provided.

CERTIORARI SHOULD BE GRANTED for the following reasons:

I.

The decision of the Circuit Court of Appeals involves the determination of an important question of Federal law, which has not been but should be settled by this Court, namely, the character, scope and effect of the lien accorded to the United

States of America by Federal Statutes for the collection of Federal Estate Taxes. More particularly it concerns the impact of that lien on the property of Respondent's citizens who are complete strangers to the transaction which gives rise to the tax.

II.

The decision of the Circuit Court of Appeals involves the determination of a question of substance, which has not been but should be settled by this Court, relating to the construction and application of statutes of the United States of America, namely, *Section* 315 (*a*) *of the Revenue Act of* 1926 (*Section* 827 (*a*) *of the Internal Revenue Code*) *and Section* 3186 *of the Revised Statutes, as amended* (*Sections* 3670 *to* 3677 *of the Internal Revenue Code, as amended*). Specifically that decision deals with the proper relationship between those two sections and their effect on the property of citizens not themselves parties to the taxed transaction but who in the course of ordinary and legitimate business affairs deal with the person liable for a tax for which a lien is imposed.

III.

The decision of the Circuit Court of Appeals involves the construction and application of statutes of the United States, namely, *Section* 315 (*a*) *of the Revenue Act of* 1926 (*Section* 827 (*a*) *of the Internal Revenue Code*) and *Section* 3186 *of the Revised Statutes, as amended* (*Sections* 3670 *to* 3677 *of the Internal Revenue Code, as amended*), which as construed and applied by the Circuit Court of Appeals are challenged as being in contravention of Article V of the Constitution of the United States. This challenge rests upon the confiscatory effect of a construction which dispenses with the requirement that notice of the lien for taxes be filed as a condition precedent to its effectiveness against innocent purchasers and encumbrancers, and upon the arbitrary and capricious discrimination in which that interpretation results in the application of those statutes to different classes of such innocent vendees and mortgagees of property having precisely the same characteristics.

IV.

The decision of the Circuit Court of Appeals has cast, and will continue to cast, a cloud upon titles of bona fide purchasers and encumbrancers of real and personal property located throughout the United States of America in which a decedent who has died within the last ten years has had any interest, and hence involves a question of general and public importance.

V.

The decision of the Circuit Court of Appeals determining as it does the scope, force and effect of the lien of the United States for the collection of Federal Estate Taxes and the ability and willingness of encumbrancers to lend money to estates in the process of liquidation vitally concerns the revenue of the United States and the collection thereof, and hence involves a question of general and public importance.

WHEREFORE, Petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Sixth Circuit, to the end that said cause may be reviewed and determined by this Court, as provided by law, and that Petitioner may have such other and further relief or remedy in the premises as to this Court may seem appropriate, and that the judgment of said Circuit Court of Appeals may be reversed by this Honorable Court.

THE DETROIT BANK,
formerly The Detroit Savings Bank,

By FERRIS D. STONE,
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EMMETT E. EAGAN,
Attorneys for Petitioner.

APPENDIX

Section 3186 *of the Revised Statutes of the United States* (*Act of July* 13, 1866, *c.* 184, *Sec.* 9, 14 *Stat.* 107 *as revised and amended by an Act of March* 1, 1879, *c.* 125, *Sec.* 3, 20 *Stat.* 331) *as amended by Act* 451, *March* 4, 1913 (*c.* 166, 37 *Stat.* 1016,) *by an Act of February* 26, 1925, *c.* 344, 43 *Stat.* 994, *by Section* 613 *of the Revenue Act of* 1928, *by Section* 509 *of the Revenue Act of* 1934 *and Section* 401 *of the Revenue Act of* 1939, *now known as Sections* 3670 *to* 3677 *of the Internal Revenue Code,* as amended, reads as follows:

"§3670. Property subject to lien

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

"§3671. Period of lien

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time."

"§3672. Validity Against Mortgagees, Pledgees, Purchasers, and Judgment Creditors

(a) *Invalidity of Lien without Notice.*—Such lien shall not be valid as against any mortgagee,

pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(1) *Under State or Territorial Laws.*—In accordance with the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law provided for the filing of such notice; or

(2) *With Clerk of District Court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law provided for the filing of such notice; or

(3) *With Clerk of District Court of the United States for the District of Columbia.*—In the office of the clerk of the District Court of the United States for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) (1) *Exception in Case of Securities.*—Even though notice of a lien provided in section 3670 has been filed in the manner provided in subsection (a) of this section, or notice of a lien provided in section 3186 of the Revised Statutes, as amended, has been filed in the manner prescribed in such section or subsection (a) of this section, the lien shall not be valid with respect to a security, as defined in paragraph (2) of this subsection, as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase, such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

"(2) *Definition of Security.*—As used in this subsection the term 'security' means any bond, debenture, note, or certificate, or other evidence of

indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

"(3) *Applicability of Subsection.*—Except where the lien has been enforced by a proceeding, suit, or civil action which has become final before the date of enactment of the Revenue Act of 1939, this subsection shall apply regardless of the time when the mortgage, pledge, or purchase was made or the lien arose."

"§3673. Release of lien

Subject to such regulations as the Commissioner, with the approval of the Secretary, may prescribe, the collector charged with an assessment in respect of any tax, may issue a certificate of release of the lien if—

(a) *Liability Satisfied or Unenforceable.* The collector finds that the liability for the amount assessed, together with all interest in respect thereof, has been satisfied or has become unenforceable by reason of lapse of time; or

(b) *Bond Accepted.* There is furnished to the collector and accepted by him a bond that is conditioned upon the payment of the amount assessed, together with all interest in respect thereof, within the time prescribed by law (including any extension of such time), and that is in accordance with such requirements relating to terms, conditions, and form of the bond and sureties thereon, as may be specified in the regulations."

"§3674. Partial Discharge of Property

(a) *Property Double the Amount of the Liability.* Subject to such regulations as the Commissioner, with the approval of the Secretary, may prescribe, the collector charged with an assessment in respect of any tax may issue a certificate of partial discharge of any part of the property subject to the lien if the collector finds that the fair market value of that part of such property remaining subject to the lien is at least double the amount of the liability remaining unsatisfied in respect of such tax and the amount of all prior liens upon such property.

(b) *Part Payment.* Subject to such regulations as the Commissioner, with the approval of the Secretary, may prescribe, the collector charged with an assessment in respect of any tax may issue a certificate of discharge of any part of the property subject to the lien if there is paid over to the collector in part satisfaction of the liability in respect of such tax an amount determined by the Commissioner, which shall not be less than the value, as determined by him, of the interest of the United States in the part to be so discharged. In determining such value the Commissioner shall give consideration to the fair market value of the part to be so discharged and to such liens thereon as have priority to the lien of the United States."

"§3675. Effects of certificates of release or Partial Discharge

A certificate of release or of partial discharge issued under this subchapter shall be held conclusive that the lien upon the property covered by the certificate is extinguished."

"§3676. Single Bond Covering Release of Lien and Payment of Income Tax Deficiency

The Commissioner, with the approval of the Secretary, may by regulation provide for the accept-

ance of a single bond complying both with the requirements of Section 272 (j) (relating to the extension of time for the payment of a deficiency) and the requirements of subsection (b) of section 3673."

"§3677. Extended Application for Provisions Relating to Release or Partial Discharge

Sections 3673, 3674, 3675, and 3676 shall apply to a lien in respect of any internal revenue tax, whether or not the lien is imposed by this subchapter."

Section 315 *of the Revenue Act of* 1926, *as amended by Section* 613 (*b*) *of the Revenue Act of* 1928 *and by Sections* 803 *and* 809 *of the Revenue Act of* 1932, *now known as Section* 827 *of the Internal Revenue Code* reads as follows:

"§827. Lien for Tax

(a) *Upon gross estate.* Unless the tax is sooner paid in full, it shall be a lien for ten years upon the gross estate of the decedent, except that such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divested of such lien. If the Commissioner is satisfied that the tax liability of an estate has been fully discharged or provided for, he may, under regulations prescribed by him with the approval of the Secretary, issue his certificate, releasing any or all property of such estate from the lien herein imposed.

(b) *Upon Property of Transferee.* If (1) except in the case of a bona fide sale for an adequate and full consideration in money or money's worth, the decedent makes a transfer, by trust or otherwise, of any property in contemplation of or intended to take effect in possession or enjoyment at or after his death, or makes a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (A) the possession and enjoyment of, or the right to the income from, the property, or (B) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom, or (2) if insurance passes under a contract executed by the decedent in favor of a specific beneficiary, and if in either case the

tax in respect thereto is not paid when due, then the transferee, trustee, or beneficiary shall be personally liable for such tax, and such property, to the extent of the decedent's interest therein at the time of such transfer, or to the extent of such beneficiary's interest under such contract of insurance, shall be subject to a like lien equal to the amount of such tax. Any part of such property sold by such transferee or trustee to a bona fide purchaser for an adequate and full consideration in money or money's worth shall be divested of the lien and a like lien shall then attach to all the property of such transferee or trustee, except any part sold to a bona fide purchaser for an adequate and full consideration in money or money's worth.

(c) *Continuance after Discharge of Executor.* The provisions of section 825 shall not operate as a release of any part of the gross estate from the lien for any deficiency that may thereafter be determined to be due, unless the title to such part of the gross estate has passed to a bona fide purchaser for value, in which case such part shall not be subject to a lien or to any claim or demand for any such deficiency, but the lien shall attach to the consideration received from such purchaser by the heirs, legatees, devisees, or distributees."

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